DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 06-0130
INCOME TAX
FOR TAX PERIOD 2000-2001

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ISSUES

I. Adjusted Gross Income Tax - Imposition

Authority: IC § 6-8.1-5-1(b); IC § 6-3-2-1(b); IC § 6-3-2-2(o); IC § 6-8.1-3-18.

The Taxpayer protests the disallowance of deductions for certain expenses.

II. Adjusted Gross Income Tax – Net Operating Loss Carryover

Authority: 26 USC § 382; IC § 6-3-2-2.6.

The Taxpayer protests the disallowance of a net operating loss carryover.

STATEMENT OF FACTS

The Taxpayer operates a delivery service. In 2002, the Indiana Department of Revenue (Department) audited the Taxpayer and assessed additional corporate income tax for tax years 1996-1998. The Taxpayer protested several issues including the department's denial of the Taxpayer's world-wide filing method and the inclusion of certain re-insurance companies in the Taxpayer's combined return. A hearing was held and a Letter of Findings issued on July 31, 2003. A rehearing was held and a Supplemental Letter of Findings was issued on September 8, 2003. In April 2004, the Taxpayer and the Department signed a Settlement Agreement stating that the Taxpayer would continue to file its returns in the same manner through 2007.

In October 2004, the Taxpayer amended its 2000 Indiana Adjusted Gross Income Tax return to take the two re-insurance companies out of the world wide combined return. The amendment resulted in a claim for refund of taxes paid. The Taxpayer filed and paid its 2001 Indiana Adjusted Gross Income tax in the same manner as reported on the 2000 amended return. After an audit of the tax period 2000-2001, the Department denied the refund for 2000 and assessed additional adjusted gross income tax and interest against the Taxpayer for 2001. The Taxpayer protested the denial of refund and the proposed assessment. A hearing was held and this Letter of Findings results.

I. Adjusted Gross Income Tax - Imposition

Discussion

Indiana Department of Revenue assessments are prima facie evidence that the tax assessment is correct. IC § 6-8.1-5-1(b). The Taxpayer bears the burden of proving that the assessment is incorrect. Id.

Indiana imposes an adjusted gross income tax on "that part of the adjusted gross income derived from sources within Indiana of every corporation." IC § 6-3-2-1(b). Indiana allows combined adjusted gross income tax returns. However, Indiana is a "water's edge" state in that Indiana cannot require foreign corporations to be included in an Indiana combined return. IC § 6-3-2-2(o). In the Settlement Agreement, however, the Department agreed that the Taxpayer could file international combined returns through the 2007 filings.

The Taxpayer argued that the Agreement only settled the issue of allowing the Taxpayer to file world-wide combined returns through 2007. According to the Taxpayer, the Agreement did not address the inclusion or the exclusion of the subject re-insurance companies. Therefore, the Taxpayer argues that a separate decision must be made as to whether or not to include the re-insurance companies in the Taxpayer's world-wide combined return. The Taxpayer argues that the issue to be determined in this Letter of Findings is whether or not, in a separate analysis, the two re-insurance companies should have been included in its 2000 and 2001 returns. The Taxpayer made several arguments concerning the propriety of including the re-insurance companies in the world-wide combined return.

The Department disagrees as to the issue to be determined in this Letter of Findings. For several reasons the Department finds that the issue is not a separate determination of the legality of excluding the reinsurance companies from the Taxpayer's world-wide combined return. Rather, the issue is whether the inclusion of the re-insurance companies in the combined world-wide return was mandated by the Settlement Agreement. If, this question falls outside the Settlement Agreement, then it would be – as the Taxpayer argues – appropriate to consider whether or not the reinsurance companies should be included in the Taxpayer's world-wide combined return as an issue separate from interpretation of the Settlement Agreement.

The Department entered into the April 2004 Settlement Agreement under authority of IC § 6-8.1-3-18. By entering this agreement, the Department took into consideration all the facts and circumstances underlying the agreement. The Settlement Agreement as executed followed naturally from those facts and circumstances. Among the facts and circumstances considered was the inclusion of the re-insurance companies in the international combined return. Both the original hearing and the rehearing addressed the issue of the inclusion of the re-insurance companies in the Taxpayer's world-wide combined return. Executing the Settlement Agreement was the final step in the resolution of the differences — including the issue of the re-insurance companies – between the Taxpayer and Department that were first considered at the initial hearing.

The Settlement Agreement stated – and the parties agreed – that the Taxpayer would use the

"same filing method" through 2007. The "filing method" included a determination of which of the Taxpayer's affiliated corporations were to be included in the returns through 2007. The Settlement Agreement is not limited to a "waters' edge" provision as alleged by the Taxpayer. The Agreement also mandates that the Taxpayer's combined world-wide returns through 2007 include the subject re-insurance companies.

Finding

The Taxpayer's protest is respectfully denied.

II. Adjusted Gross Income Tax – Net Operating Loss

Discussion

In 2001, the Taxpayer acquired the stock of an unrelated corporation that had net operating loss carryovers for federal income tax purposes. The purchased corporation had historically filed individual Indiana Adjusted Gross Income Tax Returns. At the time of its acquisition, the acquired corporation had approximately $457,440.00 of apportioned Indiana net operating loss carryovers. The Taxpayer utilized these losses on its 2001 Indiana return. As a result of the application of separate return year limitations to the losses, the Department denied the Taxpayer's utilization of these net operating losses on its 2001 combined return. The Taxpayer protested the denial.

When a loss is regulated under 26 USC § 382, the 382 rules are the prevailing rules. Standard separate return year limitations rules do not apply. The Department incorrectly applied the standard separate return year limitations rules. The Taxpayer computed its net operating loss carryover according to the appropriate guidelines found at IC § 6-3-2-2.6.

Finding

The Taxpayer's protest is sustained as to the inapplicability of the separate return year limitation rules to their net operating loss computations. The Taxpayer's computation of the net operating loss is sustained subject to audit verification.